

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

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CC:CORP:5

PLR-137158-13

Date:

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### Legend

Distributing =

Controlled =

Sub 1 =

Sub 2 =

Sub 3 =

DRE 1 =

DRE 2 =

Business A =  
Business B =  
State A =  
State B =  
a =

Dear :

This letter responds to your letter dated August 22, 2013, a request for a ruling on certain Federal income tax consequences of a proposed transaction. Additional information was received in subsequent correspondence. The material information is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process. In particular, this office has not reviewed any information pertaining to, and has made no determination regarding whether the Distribution (defined in step 3): (i) satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b); (ii) is being used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see section 355(a)(1)(B) and Treas. Reg. § 1.355-2(d)); or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50 percent or greater interest in the distributing corporation or the controlled corporation (see section 355(e)(2)(A)(ii) and Treas. Reg. § 1.355-7).

## FACTS

Distributing is a State A corporation and is the common parent of an affiliated group of corporations filing a consolidated Federal income tax return (the "Distributing Group"). Distributing owns 100 percent of the stock of each of three corporate subsidiaries: (i) Sub 1, a State A corporation, (ii) Sub 2, a State A limited liability company, classified as a corporation for U.S. Federal income tax purposes, and (iii) Sub 3, a State A

corporation. Distributing also owns all of the outstanding interests in DRE 1, a State A limited liability company which is disregarded as an entity separate from Distributing for U.S. Federal income tax purposes.

Sub 1 owns all of the outstanding interests in DRE 2, a State B limited liability company which is disregarded as an entity separate from Sub 1 for U.S. Federal income tax purposes.

The Distributing Group is engaged in Business A and Business B. Distributing conducts Business A directly, as well as indirectly through DRE 1 and Sub 3. Sub 1, DRE 2, and Sub 2 are engaged in Business B, with Sub 1 being the principal operating entity for Business B.

Distributing intends to implement the Proposed Transaction (defined below) to separate the Distributing Group's Business A from its Business B. The separation will serve the corporate business purposes of both Distributing and Controlled by: (i) creating opportunities for growth and expansion; (ii) facilitating access to capital and reducing overall cost of capital; (iii) establishing valuable acquisition currencies for use in possible future transactions; (iv) increasing administrative efficiency; (v) permitting management to focus on the particular market segments, value drivers, and opportunities unique to each business; and (vi) increasing the ability to attract and retain top quality management and employees.

### **PROPOSED TRANSACTION**

For what are represented as valid business reasons and to achieve the objectives discussed above, Distributing proposes the following steps:

1. Distributing will form Controlled with nominal capital.
2. Distributing will contribute 100 percent of the stock of Sub 1 and 100 percent of the membership interests in Sub 2 to Controlled solely in constructive exchange for additional shares of Controlled (the "Contribution").
3. Distributing will distribute 100 percent of the stock of Controlled to Distributing's shareholders on a pro-rata basis (the "Distribution").

In connection with the Proposed Transaction, Distributing and Controlled will enter into certain new agreements relating to the separation of Business A from Business B and will allow certain existing commercial agreements to survive the Distribution (the "Continuing Commercial Arrangements" and collectively, with the new agreements, the "Continuing Arrangements"). The Continuing Arrangements are comprised of a

Separation and Distribution Agreement, a Tax Matters Agreement, a Transition Services Agreement, an Employee Matters Agreement, a Shareholder Agreement, Leasing Agreements, and the Continuing Commercial Arrangements.

Pursuant to the Leasing Agreements, Controlled will sub-lease office space from Distributing for a period of up to two years after the Distribution, at which time Controlled intends to move to a separate location. In the event it is impracticable for Controlled to do so within the two year period following the Distribution, Controlled may continue to sub-lease its existing office space from Distributing at arm's length terms, or enter into a direct lease at arm's length terms with the owner of its current space, until such time as Controlled is able to locate a suitable alternative. Pursuant to the Continuing Commercial Arrangements, Controlled will provide to Distributing a services at arm's length terms.

Pursuant to the Transition Services Agreement, Distributing will provide certain transition services, such as administrative, human resources, financial reporting, cash management, payroll, risk management, land and information technology services, to Controlled and Controlled will provide certain transition services, such as engineering, design, accounting and measurement services, to Distributing for a period of two years or less. Controlled will pay Distributing, and Distributing will pay Controlled, for the services provided under the Transition Services Agreement at arm's length terms or on a cost basis.

Immediately following the Distribution, and for a limited transition period, it is expected that all or most of the members of Distributing's board of directors will serve on Controlled's board of directors. Twelve months after the Distribution, only a minority of Distributing's and Controlled's directors will overlap. Immediately following the Distribution, and for a limited transition period, it is expected that certain Distributing officers may serve as Controlled officers (the "Overlapping Officers"). Twelve months after the Distribution, there will be no overlap of Distributing's and Controlled's officers.

## **REPRESENTATIONS**

The following representations are made with respect to the Contribution and Distribution.

- (a) The indebtedness, if any, owed by Controlled to Distributing after the Distribution will not constitute stock or securities.

- (b) No part of the consideration to be distributed in the Distribution will be received by any shareholder of Distributing as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (c) Distributing will treat all members of its separate affiliated group (within the meaning of section 355(b)(3)(B)) (the “Distributing SAG”) as one corporation in determining whether it meets the requirements of section 355(b)(2)(A) regarding the active conduct of a trade or business.
- (d) The five years of financial information submitted by Distributing with respect to Business A conducted by the Distributing SAG is representative of its present operations, and with regard to Business A, there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) Controlled will treat all members of its separate affiliated group (within the meaning of section 355(b)(3)(B)) (the “Controlled SAG”) as one corporation in determining whether it meets the requirements of section 355(b)(2)(A) regarding the active conduct of a trade or business.
- (f) The five years of financial information submitted by Controlled with respect to Business B conducted by the Controlled SAG is representative of its present operations, and with regard to Business B, there have been no substantial operational changes since the date of the last financial statements submitted.
- (g) The distribution of Controlled stock to shareholders in the Distribution will be with respect to the shareholders’ ownership of Distributing stock.
- (h) Any money, property or stock contributed by Distributing to Controlled in the Contribution will be exchanged solely for stock or securities, if any, in Controlled.
- (i) The Distributing SAG neither acquired Business A nor acquired control of an entity conducting Business A during the five-year period ending on the date of the Distribution in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part, excluding in each case acquisitions that constitute expansions, as contemplated by Treas. Reg. § 1.355-3(b)(3)(ii), of Business A. Throughout the five-year period ending on the date of the Distribution, the Distributing SAG has been the principal owner of the goodwill and significant assets of Business A and the Distributing SAG will continue to be the principal owner following the Distribution.

- (j) The Controlled SAG neither acquired Business B nor acquired control of an entity conducting Business B during the five-year period ending on the date of the Distribution in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part excluding in each case acquisitions that constitute expansions, as contemplated by Treas. Reg. § 1.355-3(b)(3)(ii), of Business B. Following the Distribution, the Controlled SAG will be the principal owner of the goodwill and significant assets of Business B.
- (k) Following the Proposed Transaction, the Distributing SAG and Controlled SAG will each continue the active conduct of its business, independently and with its separate employees, except for the Overlapping Officers, and as provided pursuant to the Continuing Arrangements.
- (l) The Distribution will be carried out for the following business purposes: (i) creating opportunities for growth and expansion; (ii) facilitating access to capital and reducing the overall cost of capital; (iii) establishing valuable acquisition currencies for use in possible future transactions; (iv) increasing administrative efficiency; (v) permitting management to focus on the particular market segments, value drivers, and opportunities unique to each business; and (vi) increasing the ability to attract and retain top quality management and employees. The Distribution is motivated, in whole or in substantial part, by these corporate business purposes.
- (m) The Proposed Transaction is not used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.
- (n) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.
- (o) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled stock, that was either (i) acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after

applying section 355(d)(6)) ending on the date of the Distribution, or (ii) attributable to distributions on Distributing stock or securities that were acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.

- (p) The fair market value of the assets transferred to Controlled in the Contribution will equal or exceed the adjusted basis of these assets.
- (q) The total fair market value of the assets transferred to Controlled by Distributing in the Contribution will exceed the sum of (i) the total liabilities assumed (within the meaning of section 357(d)) by Controlled, (ii) the amount of any liabilities owed to Controlled by Distributing that are discharged or extinguished in connection with the Contribution, and (iii) the total amount of any money and the fair market value of any other property (within the meaning of section 361(b)) received by Distributing from Controlled in connection with the Contribution.
- (r) The fair market value of the assets of Controlled will exceed the amount of its liabilities immediately after the Contribution.
- (s) The total adjusted basis of the assets transferred to Controlled in the Contribution will exceed the sum of (i) the liabilities assumed (within the meaning of section 357(d)) by Controlled and (ii) the total amount of money and the fair market value of any other property (within the meaning of section 361(b)) received by Distributing and transferred to its creditors and/or shareholders in connection with the plan of reorganization.
- (t) The liabilities assumed (within the meaning of section 357(d)) by Controlled in the Contribution, if any, and any liabilities to which the transferred assets are subject, were incurred in the ordinary course of business and are associated with the assets being transferred.
- (u) No investment credit determined under section 46 has been (or will be) claimed with respect to any property contributed to Controlled by Distributing in connection with the Contribution.
- (v) Except potentially pursuant to the elimination or reduction of intercompany balances in connection with the Proposed Transaction, Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Proposed Transaction.

- (w) No income items, including accounts receivable or any item resulting from a sale, exchange or disposition of property, that would have resulted in income to Distributing, and no items of expense will be transferred to Controlled if Distributing has earned the right to receive the income or could claim a deduction for the expense under the accrual or similar method of accounting.
- (x) Except for indebtedness that may be created in the ordinary course of business, including intercompany open account balances and the Continuing Arrangements, no intercorporate debt will exist between Distributing (and its subsidiaries) and Controlled (and its subsidiaries) at the time of, or subsequent to, the Distribution.
- (y) No indebtedness between Distributing (and its subsidiaries) and Controlled (and its subsidiaries) was issued, acquired or will be settled at a discount or cancelled in connection with the Distribution.
- (z) Immediately before the Distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations (see Treas. Reg. §§ 1.1502-13 and 1.1502-14 as in effect before the publication of T.D. 8597, 1995-2 C.B. 147, and as currently in effect; Treas. Reg. § 1.1502-13 as published by T.D. 8597). Further, any excess loss account of a member in the stock of another member that is required to be taken into account by Treas. Reg. § 1.1502-19 will be included in income.
- (aa) Except with respect to certain payments made pursuant to the Continuing Arrangements, payments made in connection with continuing transactions between Distributing (or any of its subsidiaries) and Controlled (or any of its subsidiaries) following the Distribution will be based on terms and conditions arrived at by parties bargaining at arm's length. Distributing and Controlled believe that the terms and conditions of the agreements relating to the a services to be provided by Controlled to Distributing after the Distribution will be consistent with terms and conditions that would have been realized if uncontrolled taxpayers had engaged in comparable transactions under comparable circumstances.
- (bb) No two parties to the Distribution are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (cc) Distributing, Controlled, and Distributing's shareholders will pay their expenses, if any, incurred in connection with the Distribution.

- (dd) The Distribution is not part of a plan or series of related transactions (within the meaning of Treas. Reg. § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50 percent or greater interest (within the meaning of section 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).
- (ee) Immediately after the transaction (as defined in section 355(g)(4)), (i) any person that holds a 50 percent or greater interest (within the meaning of section 355(g)(3)) in any disqualified investment corporation (within the meaning of section 355(g)(2)) will have held such an interest in such corporation immediately before the transaction, or (ii) neither Distributing nor Controlled will be a disqualified investment corporation (within the meaning of section 355(g)(2)).

### **RULINGS**

Based solely on the information submitted and the representations set forth above, and provided that (i) the distribution of Controlled stock to Distributing's shareholders in the Distribution is with respect to their ownership of Distributing stock, (ii) any money, property, or stock contributed by Distributing to Controlled in the Contribution is exchanged solely for stock or securities in Controlled, and (iii) any other transfer of stock, money, or property between Distributing, Controlled, or any Distributing shareholder and any person related to Distributing, Controlled, or any Distributing shareholder is respected as a separate transaction, we rule as follows:

1. The Contribution, together with the Distribution, will qualify as a reorganization within the meaning of section 368(a)(1)(D). Distributing and Controlled each will be a "party to a reorganization" within the meaning of section 368(b).
2. Distributing will recognize no gain or loss upon the Contribution. Sections 357(a) and 361(a).
3. Controlled will recognize no gain or loss upon the Contribution. Section 1032(a).
4. Immediately after the Contribution, Controlled's basis in each asset received in the Contribution will equal the basis of such asset in the hands of Distributing immediately before the Contribution. Section 362(b).
5. Controlled's holding period in each asset received from Distributing in the Contribution will include the period during which Distributing held such asset. Section 1223(2).
6. Distributing will recognize no gain or loss upon the Distribution. Section 361(c).

7. Distributing shareholders will not recognize any gain or loss (and will not otherwise include any amount in income) upon receipt of Controlled stock in the Distribution. Section 355(a)(1).
8. Immediately after the Distribution, the basis in the hands of each Distributing shareholder of the Distributing stock and the Controlled stock that is distributed in the Distribution will equal the basis of the Distributing stock with respect to which the Distribution is made, allocated in proportion to the fair market values of the Distribution in accordance with Treas. Reg. § 1.358-2(a)(2). Section 358(a)(1), (b) and (c).
9. The holding period in the Controlled stock received by each Distributing shareholder in the Distribution will include the holding period of the Distributing stock with respect to which the Distribution is made, provided the Distributing stock was held as a capital asset on the date of the Distribution. Section 1223(1).
10. Earnings and profits will be allocated between Distributing and Controlled in accordance with section 312(h) and Treas. Reg. §§ 1.312-10(a) and 1.1502-33(e).
11. Except for purposes of section 355(g), payments made between any of Distributing and Controlled and their respective affiliates under any of the Continuing Arrangements regarding liabilities, indemnities, or other obligations that (i) have arisen or will arise for a taxable period ending on or before the Distribution or for a taxable period beginning before and ending after the Distribution and (ii) will not become fixed and ascertainable until after the Distribution, will be viewed as occurring immediately before the Distribution (cf. *Arrowsmith v. Commissioner*, 344 U.S. 6 (1952); Rev. Rul. 83-73, 1983-1 C.B. 84).

### CAVEATS

No opinion is expressed about the tax treatment of the Proposed Transaction or of any other matter under other provisions of the Code or regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transaction not specifically covered by the above rulings. In particular, no opinion is expressed regarding:

- i. Whether the Distribution satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b);
- ii. Whether the Distribution is used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both (see section 355(a)(1)(B) and Treas. Reg. § 1.355-2(d)); or

- iii. Whether the Proposed Transaction is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50 percent or greater interest in the Distributing or the Controlled (see section 355(e) and Treas. Reg. § 1.355-7).
- iv. The Federal tax treatment of any cost basis payment related to the Continuing Arrangements.
- v. The Federal tax treatment of Distributing and Controlled eliminating intercompany indebtedness through cash repayment or set-off.

### PROCEDURAL MATTERS

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that this letter may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of this ruling letter.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

*Douglas C. Bates*

Douglas C. Bates  
Senior Technician Reviewer, Branch 6  
Office of Associate Chief Counsel (Corporate)

cc: